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Leading Through the
Financial Crisis

*Three Opportunities
For the Chief
Information Officer*



Contact Information

New York

John Plansky

Partner

212-551-6492

john.plansky@booz.com

Amit Gupta

Partner

212-551-6823

amit.gupta@booz.com

Mehul Desai

Senior Associate

212-551-6720

mehul.desai@booz.com

Deirdre Reynaud also contributed to this Perspective.

EXECUTIVE SUMMARY

Financial institutions are facing an unprecedented set of pressures, brought about by the recent upheaval in global markets. Those pressures have, in turn, created a new set of imperatives for IT departments in addition to their current priorities. To manage this balancing act, we recommend that IT take a strong and distinct leadership role, with an emphasis on three areas. First, IT should commit only to high-priority projects in which the business and IT both have a clear understanding of the outcome. Second, leaders should create an IT operating model that promotes accountability and structures the IT function to deliver improved services more efficiently. Finally, it's time to put the "I" back in "IT" and install a new level of transparency regarding the crucial information that the institution needs. In embracing these opportunities, CIOs can establish themselves as leaders in a time of crisis. By failing to do so, they may well undermine their company's quest for advantage during this turbulent time.

A HISTORIC OPPORTUNITY FOR CHANGE

The current economic crisis is redefining the financial services industry, as a wave of consolidation has produced a number of surviving “megabanks,” forcing the rest of the industry to adjust accordingly. Furthermore, the crisis has created unprecedented concerns regarding the financial institutions’ balance sheets and risk profiles. This rapidly changing environment, in which financial institutions are struggling to maintain their advantage, is putting IT under intense and immediate pressure to deliver the right services at lower cost.

In addition, financial institutions will soon face a number of new challenges: As the wave of consolidations ebbs, a new competitive and regulatory environment will emerge—and will necessitate IT support for the implementation of new risk management and regulatory controls. In this environment, characterized by a number of shotgun weddings, many financial institutions will need to dedicate substantial effort to postmerger integration activities. IT organizations must integrate the operations and technology platforms of other institutions, under the dual pressures of extremely limited time and the expectation of flawless execution. In addition, each segment of the financial services industry will have its own unique challenges brought about by the crisis that will require the response of IT. Regional banks, for instance, will have to improve their cost-to-income ratio by five to 10 points to compete with the scale advantages of the megabanks,

while simultaneously extending their customer capabilities. And just as IT departments are adapting to these new priorities, IT spending will be under increased scrutiny and a likely target for cost cutting.

But with crisis comes opportunity. In this historic moment, CIOs and IT organizations can take three critical steps to ensure the success of their institutions now and in the future.

1. Reassess IT priorities and commit only to high-value initiatives.

Financial institutions are competing in a zero-sum game for the talent and resources to deliver high-quality execution. Business executives continue to express frustration with IT’s track record for delivery, in which more than half of projects fail to meet expectations and less than 30 percent of total IT spending is focused on strategic initiatives. And now, three new priorities are being thrust on financial institutions’ IT organizations: postmerger integration, operations restructuring, and risk and financial management. To address these new imperatives in the context of the current backlog, business leaders must jointly reexamine their priorities with IT and commit to a rigorous and disciplined approach for choosing and executing projects.

Often implemented loosely, IT demand management is now more critical than ever to deal with conflicting priorities and ensure that IT is supporting the most crucial needs of the business units. Financial institutions have made a number of missteps in demand management that cannot continue: ignoring investment hurdles, proceeding on projects without a clear understanding of the expected outcomes, loosely monitoring project progress, or failing to bring together the right IT and business decision makers.

During this time of upheaval, when difficult trade-offs need to be made, banks must reform the decision process and guarantee that the relevant stakeholders from IT and the business participate. Only then will the organization gain true control over its deployment of IT resources and capital.

As the IT budget is stretched to address multiple initiatives, the governance body for managing investments must address three key areas: First and foremost, executives must reevaluate the current project portfolio and decisively kill poorly performing projects to make way for high-value initiatives. Second, IT will be charged with the difficult task of carving out additional capacity for upcoming merger integration, cost restructuring, and regulatory and risk management initiatives. Third, IT and the business must come to a consensus on the resource and investment requirements for other critical initiatives, including organic growth, operational efficiencies, and core technology upgrades.

Execution will also be critical, as today’s environment provides no margin for error. In setting priorities, IT organizations must realistically assess whether they have the necessary capabilities for each project. Large-scale programs or initiatives in which the department has little experience should be outsourced to reduce the potential for error. Once the new priorities and sourcing arrangements have been established, the IT organization must relentlessly manage execution in order to ensure the maximum return.

2. *Restructure the IT operating model.* IT must enable these new business initiatives and also respond to calls to reduce its cost structure. To efficiently act on new imperatives and maintain critical, ongoing activities, IT organizations need to reduce complexity and eliminate costs that don't add value. The right strategic IT operating model can reduce costs by as much as 20 percent, freeing resources for strategic projects without compromising the projects that keep the "lights on." To achieve these targets and establish a simpler IT structure, financial institutions need to address four key areas:

- *Operating Model Structure:* IT must structure itself in a way that will allow it to deliver effectively against these imperatives while promoting clear accountability for results. For instance, many IT organizations are currently structured in silos, with an inefficient mix of capabilities devoted to specific business units that could potentially be shared. IT needs a structure that makes the best use of both business unit-specific and cross-functional capabilities and incorporates common processes and governance, as well as better information flow, to improve the performance of the overall IT organization. In this manner, IT can meet business expectations and establish clearer decision rights within the organization, which will lead to greater accountability. In addition, the target operating model permanently eliminates the sources of unnecessary costs, such as wasted spending in software and open systems, insufficient capacity in low-cost locations across all IT functions, and ineffective use of strategic partners, especially third-party services providers.

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- *People:* Cuts to the workforce are inevitable at this time. Financial institutions need to establish a clear workforce plan that defines the roles, numbers, level, and skills of the retained IT organization and the corresponding expected capacity and capabilities of third parties. At least 40 percent of staff across all IT functions, including infrastructure, should be on a variable basis and staffed in a low-cost location. Furthermore, in determining the best way to deploy its people, the IT organization should have the architecture and design function take a lead role in simplifying the technology environment. In many financial institutions, this function has become a team of backseat drivers and observers of the process rather than the best and brightest engineers. They can be better used in support of the initiatives detailed here.
- *Applications:* Financial institutions must rationalize their current application portfolios, which often have more than a thousand applications, and establish target architectures and platforms to eliminate duplicate functions, work, support costs, and infrastructure. Given the immediate need for merger integration and restructuring, there is no better time to make substantial progress in this regard. Furthermore, financial institutions should have a deeper understanding of when to buy and when to build—and make use

of services-based architectures to promote the reuse of applications across the enterprise.

- *Infrastructure:* IT needs to curb infrastructure spending. Keeping the lights on while reducing infrastructure costs is always a balancing act for the CIO. But, in fact, the infrastructure function may be the greatest beneficiary of a simplified operating model and technology environment. Proven methods of infrastructure cost restructuring, such as data center consolidation, virtualization, and enterprise management of hardware and software, are stymied by undisciplined operating models and overly complex application environments. In addition, infrastructure needs to catch up with the rest of the industry in taking advantage of low-cost locations and, once again, review the opportunities offered by outsourcing.

These areas of focus can reduce costs now while establishing a more effective IT organization for the future. To execute these strategic changes, the CIO should consider the appointment of a very strong IT executive, an "IT COO," to lead the restructuring and make the most of opportunities to accelerate these changes as part of significant programs, such as large-scale merger integration.

3. *Put the “I” back in “IT.”* All financial institutions are now faced with increased regulatory pressures and the need for up-to-date information in response to an increasingly varied set of urgent requests. In many cases, firms are still relying on e-mail, phone calls, and disparate systems to aggregate this critical information to run the enterprise and manage risk. The financial crisis has clearly shown that these methods are not adequate and will not be acceptable going forward.

There are critical information requirements across the enterprise, including information about clients, counterparties, investments, products, and other third parties. This increased need for information transparency is straining underserved management information systems (MIS) functions such as analytics, reporting, and corporate systems (e.g., risk and financial management). To alleviate this strain, IT must develop an approach that takes advantage of its unique view across the enterprise, leverages core data and information management technologies, and fosters closer working relationships with risk and compliance departments.

In many cases, the best approach is a commitment to making MIS a top priority and aggressively building on initiatives that are already under

way. For example, institutions that properly structured their Basel II solutions can consider expanding that infrastructure to capture additional information across the enterprise. In addition, information needs to be presented in a meaningful way to executives. Doing so will let them quickly synthesize the meaning of data, aggregated across the enterprise regarding customers, counterparties, instruments, and underlying assets. CIOs need to take responsibility for information-intensive initiatives and will be accountable for delivering real-time and accurate information at the corporate and business unit levels.

While risk and compliance management has not always been a key focus area for IT’s best engineers, it needs to be now. Banks will need to invest in data, workflow, analytics, and reusable services at the enterprise level to deliver against these information-intensive initiatives. However, this is not just a technology problem: Significant investments in decision methods, process engineering, and data classification will be required. Regardless, in the current market environment, financial institutions need to ensure that IT can convert pieces of data from various silos in the organization into meaningful information if it is to manage the business effectively.

IT must develop an approach that takes advantage of its unique view across the enterprise.

CONCLUSION

There’s no question that IT organizations within financial institutions are looking at a maelstrom of activity and difficult decisions in the coming months, as they support banks’ need to keep costs down while continuing to grow in the face of substantial challenges. But the CIOs who can find focus in the eye of the storm and act on these three recommendations will not just fulfill their obligations. They will establish themselves as leaders in the organization. In two years, the winning IT organizations will be the ones that have made these adjustments and established IT executives as key leaders in a time of crisis.

Endnotes

¹ For an in-depth analysis of how banks can cut costs without sacrificing growth, see "The Seven Deadly Sins of Cost Reduction," by Paul Hyde, Jai Sinha, and Brodie Dixon, Booz & Company, 2008: http://www.booz.com/global/home/what_we_think/reports_and_white_papers/ic-display/428266300

About the Authors

John Plansky is a partner with Booz & Company in New York. He specializes in IT strategy, IT restructuring, large-scale transformations, and outsourcing initiatives for financial services firms.

Amit Gupta is a partner with Booz & Company in New York. He specializes in managing large-scale operations and technology transformation programs for financial services firms.

Mehul Desai is a senior associate with Booz & Company in New York. He specializes in IT transformation for financial services firms.

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